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SUBJECT: U/S JEFFERY,S MEETING WITH CENTRAL BANK GOVERNOR
MEIRELLES

¶1. (SBU) SUMMARY. Under Secretary Reuben Jeffery met with Central Bank of Brazil (CBB) Governor Henrique Meirelles October 21 on the margins of the World Bank/IMF Annual Meeting. They discussed the need for and impediments to infrastructure investment in Brazil, impact of recent financial market turbulence on Brazil, and the prospects for a Brazilian sovereign wealth fund (SWFs). END SUMMARY.

Infrastructure Investment a Struggle

¶2. (SBU) Following up on themes from their meeting in Sao Paulo in August, Meirelles told U/S Jeffery that the GoB,s efforts to increase foreign investment in Brazil face three "bottlenecks: infrastructure, a lack of skilled workers, and an inconsistent regulatory environment. He said that bringing regulatory surety by removing Brazilian law,s concept of &Social Justice8 would prove the most difficult issue to solve. Meirelles noted a large amount of capital flowing into Brazil (maybe too much, he commented), but a shortage of good projects and ideas are available to effectively utilize the capital. He added that the successful toll road concession auctions had taken 6 to 7 years, and a complete change in philosophy, to finally overcome internal political and environmental problems.

Recent Credit Crunch Leaves No Lasting Impact

¶3. (SBU) Meirelles noted that the recent problems in world capital markets had an immediate and pronounced impact on Brazil, with risk spreads increasing and the Real dropping from 1.85 to 2.13 per dollar. However, as the crisis subsided, risk spreads returned to normal and the Real rebounded to 1.80 per dollar. He mentioned that CBB started buying dollars again last week and that there were significant dollar inflows to Brazil on &Black Friday8 two days prior to the meeting. Meirelles also sees a need to refocus on Basel II and ensure that bank capital allocation requirements for pledged liquidity lines are put in place. U/S Jeffery agreed that the banking system was more leveraged than analysts realized and that bank regulators must address structured investment vehicle accounting.

Sovereign Wealth Funds) No Issue in Brazil

¶4. (SBU) Due to Brazil,s very strict fiscal responsibility regulations, CBB cannot invest reserves in SFWs, according to Meirelles. A SFW direct investment would be considered a primary expense of the GoB and affect its budget. CBB can only invest in corporate securities or financial instruments if there were no prospect of controlling the company. He

added that CBB needs to stay very liquid and has approximately \$160 billion in reserves of which \$90 billion are invested in US Treasury securities. (Note: According to press reports, Finance Minister Mantega recently said that a Brazilian SWF could start with \$10 billion in surplus foreign exchange reserves.)

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